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C O N F I D E N T I A L SECTION 01 OF 02 ZAGREB 000832

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SUBJECT: CROATIA SEEKS ADDITIONAL GAS IMPORTS

Classified By: Economic Officer Nicholas Berliner, 1.4 b/d.

¶1. (C) Summary: Although Croatia has ample supplies of natural gas to meet current demand, increasing consumption, combined with dwindling domestic production and static imports, means the country could face shortfalls in the coming years without new sources of supply. Demand is forecast to exceed current supply perhaps as early as 2009. This shortfall could be met by a planned LNG terminal on the Adriatic coast, but such a terminal could only come on line well after 2009. Talks with Russia to increase imports have gone nowhere, with Russia's Gazprom seeking investment in Croatia's energy infrastructure as the price for greater gas volumes, a price the GOC has thus far been unwilling to pay. End Summary.

¶2. (U) Croatia currently imports 1.1 billion cubic meters (bcm) of gas from Russia that enters the country by pipeline from Slovenia. The balance of its approximately 3.3 bcm consumption is met from domestic production, both continental and offshore. Domestic production, however, is expected to peak by 2009. In the meantime, the GOC has been investing in expansion of the country's gas network, building a trunk line into Dalmatia and other previously unserved regions of the country. Concurrently, Croatia's main energy company, INA, has been investing in upgrades of its fuel refineries that will be powered by gas, and the electricity group HEP has several new gas-fired thermal plants planned to meet growing electricity demand over the next few years. Together, these projects are estimated to increase gas demand by 500 million cubic meters (mcm) by the end of the decade, in addition to a natural demand growth of 3 - 3.5 percent annually. Unless Croatia secures new sources of supply within the next two years, shortfalls are likely.

¶3. (C) Energy Assistant Minister Zeljko Tomsic told EconOff recently that Croatia has been unsuccessful in talks with Gazprom to secure additional import volumes. Rather than using existing import routes, Croatia has sought to open a new pipeline from Hungary, but finds itself in a classic Catch-22. The Hungarian side says it would build the pipeline if Croatia can secure gas contracts from Russia. However, the Russians have said (disingenuously, according to Tomsic) that they will not agree to supply the gas without a pipeline in place. Tomsic said it has been clear from the talks with the Russians on this issue that they are withholding additional gas volumes not for lack of a pipeline, but to pressure the GOC to open up construction of new municipal gas systems to Russian companies. (Note: The Russians have been in a general pique with Croatia over perceived discrimination against Russian business interests in Croatia for some time, with Putin complaining about this during a visit earlier this year.)

¶4. (C) Goran Granic, president of the Croatian Energy Society and a former deputy premier, believes Croatia should

link its gas grid to Serbia, where he says sufficient volumes already are available. Granic thinks that political considerations stand in the way of this option. However, INA Senior Advisor Stevo Kolundzic told EconOff that the Serbian option, which looked attractive several years ago, now appears more and more like a Gazprom Trojan Horse and an element of the Russian "South Stream" project aimed at striking a dagger in the heart of the NABUCCO pipeline project. Kolundzic also opined on the behavior of Hungary in this regard (MOL is a 25% shareholder in INA), saying that its ambiguous position on "South Stream" was also a move against NABUCCO, since an OMV-dominated NABUCCO would enhance Austria's position as a gas storage hub to the detriment of Hungary's ambitions in this area.

15. (C) Tomsic concluded that a country as small as Croatia with a relatively small gas market is in a weak position and unable to influence substantially the construction or direction of major energy pipelines. In that context, he said the GOC's strategy is to develop its domestic infrastructure in such a way as to be able to connect to any or several of the pipeline routes that have been mooted for Southeast Europe, be they for Russian or Caspian gas. Tomsic acknowledged that Croatia's position vis-a-vis Russia will weaken with time, as the need for additional gas becomes more acute and Russia remains the sole supplier.

16. (C) Long-term, the GOC remains committed to building an LNG terminal on the Adriatic coast, a project with an envisioned final capacity of 14 bcm annually. Tomsic admitted that progress on concluding a shareholder's agreement has been slow, as has a final decision on a location for the facility. Although it seems certain that the final location will be the island of Krk, Tomsic conceded

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that the GOC would not make any major decisions on the project prior to this November's parliamentary elections. INA's Kolundzic criticized the GOC's handling of the LNG issue, saying that the Government has failed to appreciate the fact that Croatia cannot set the terms of a project it is not financing. He said work has continued in the background in spite of the GOC's stalling, but fears that the 2012 window for an initial LNG delivery is closing.  
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